No. 3612

IN THE

United States
Circuit Court of Appeals
For the Ninth Circuit

H. C. ANDERSON, *Appellant*,

vs.

O. H. AVEY and PAYETTE VALLEY LAND AND ORCHARD COMPANY, Ltd., a corporation, *Appellees*.

BRIEF OF APPELLANT

Upon Appeal from the District Court of the United States, District of Idaho, Southern Division

HAWLEY AND HAWLEY,
JAMES H. HAWLEY,
JESS HAWLEY,
O. W. WORTHWINE,
SAM S. GRIFFIN,
Residence: Boise, Idaho.

JOHN H. NORRIS,
Residence: Payette, Idaho,
Solicitors for Appellant.

SYMS-YORK CO., PRINTERS & BINDERS, BOISE

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STATEMENT OF THE CASE

This is an appeal from a decree of dismissal, following the ruling of the court sustaining appellees' (defendants') objection to the introduction of any evidence upon the trial of the cause, upon the ground that the complaint did not state facts sufficient to constitute a cause of action against appellees' (defendants). The propriety of such ruling and the

dismissal following, rests upon the sufficiency of the allegations of the complaint with such aider as there may be in the answer, no objection to the complaint having been raised prior to calling the cause for trial upon the issues of the complaint and the appellees' answer. A synopsis of the complaint follows:

The appellant alleges that he is, and was at all times mentioned, a citizen and resident of the State of Oregon (Record, page 7) and a stockholder in appellee corporation, at this time owning 304 shares of stock (page 9); that appellee, Avey, is, and was at all times mentioned, a citizen and resident of the State of Idaho, and appellee Payette Valley Land & Orchard Company, Limited, is an Idaho corporation, organized April 19, 1910, with its principal place of business at Payette, Payette County, Idaho; that by its articles of incorporation, it was authorized to issue capital stock in the amount of 2500 shares of the par value of $100.00 per share (page 8); to buy, sell, hold, etc., real estate; that appellee Avey, since the organization of the corporation has been a member of the Board of Directors and President of appellee corporation, and owner and record holder of 215 shares of its stock; that one R. E. Haynes is, and has been owner and record holder of 60 shares; L. V. Patch of 106 shares, M. F. Alberts of 215 shares, A. P. Scritchfield of 208 shares, and C. E. Larson of 104 shares of the stock of said corporation, and are the elected and acting corporate directors, owning 912 (a majority) of the 1428 issued shares (pages 9-10).

That the corporation's by-laws make it the duty of the Board to cause issuance to stockholders in proportion to their several interests certificates of stock not to exceed in the aggregate the capital stock.

On or about February 1, 1910, in violation of such by-laws, the directors then in office, namely: appellee Avey, and the above named Scritchfield, Patch and Haynes, together with J. W. Roberts and Otto C. Miller, without the knowledge or consent of plaintiff, caused to be issued and there were issued 100 shares of the corporation stock, par value of $100.00 per shares, to each of said persons (page 10). The stock was issued as fully paid up and purported to be in consideration of a one-seventh equity in certain lands consisting of about 240 acres situate in Canyon County, State of Idaho, but said persons, and none of them, had any equity in such land or any part thereof except an option to purchase it, which option was not of the value of said shares of stock so issued, to-wit: $70,000.00, or of any value at all to said corporation. Upon information and belief, the appellant further alleges that there was no real or valuable consideration for the issuance of said 700 shares of stock, and that no part of the face or par value has ever been paid, of all of which said directors had knowledge. Between March 21, 1912, and September 21, 1915, in violation of the by-law before mentioned, without the knowledge or consent of plaintiff, the same board of directors authorized the issuance of, and there were issued 662 more shares of the capital stock of appellee company of the par value of $100.00 per share, to themselves as individuals, as fully paid up, though, in fact, sold for twenty-five dollars per share, and there remains unpaid upon said last stock the sum of $49,650.00, of which appellee Avey owes $8700.00, having purchased 116 of said shares. Thereafter, without the knowledge or consent of plaintiff, the same board authorized the issuance, and there were issued, to

various persons to plaintiff unknown 28 shares of stock in the corporation of the par value of $100.00 per share, issued as fully paid up but, in fact, sold for twenty-five dollars per share, and there remains unpaid thereon the sum of $2100.00. That there is due defendant corporation from the persons to whom said stock was issued the sum of $121,750.00 (pages 11-12).

In March, 1914, defendant corporation, through a majority vote of its directors, borrowed $5000.00 of the Wallace National Bank of Wallace, Idaho, and loaned one-half of such amount to certain of its directors, without the knowledge or consent of plaintiff, in direct violation of the laws of the State of Idaho (page 12).

In December, 1917, the appellee O. H. Avey and the other persons above named as constituting the board of directors and holders of a majority of the stock of said corporation, as directors and stockholders, passed resolutions levying an assessment amounting to $900.00 on appellant's stock for the alleged purpose of raising funds with which to pay debts of the corporation, but upon protest of the plaintiff, the resolution was rescinded; plaintiff, on information and belief, alleges that on account of the condition of the appellee corporation, further assessments will be made (page 13). The above named directors and the appellee corporation have refused to make a call upon the defendant O. H. Avey for the amount unpaid upon the said stock purchased by him, and this action is brought by the appellant for the benefit of the corporation to require and compel the appellee Avey to pay the same to the corporation. Between the 1st of January, 1915, and the filing of the complaint, the appellee corporation be-

came indebted to various parties in large sums of money, the exact amount being unknown to the appellant, but he is informed and believes and alleges, therefore, that the corporation is now, and for four years last passed has been indebted to various creditors in the sum of $60,000.00 in excess of its assets; that it has no funds with which to pay its indebtedness, and that it is necessary that the corporation collect the amounts unpaid upon the stock purchased by the appellee, as before alleged, in order to pay its creditors, and if it does so collect from said appellee and the other stockholders who secured stock under similar circumstances, the corporation will have sufficient funds with which to pay its creditors and continue operating as a going concern; and unless it does so collect, it will become insolvent and unable to pay its creditors (pages 27, 28).

It is further alleged that appellant has agreed to pay his attorneys a reasonable attorneys' fee for prosecuting the action and that $1000.00 is a reasonable fee which should be paid to the appellant (page 28). It is then alleged that appellee O. H. Avey is indebted to appellee corporation for such stock in the sum of $18,700.00, and appellant has made a demand on the other stockholders of the corporation and on its board of directors to institute an action to recover said sum from said O. H. Avey, but that because all the officers, directors and stockholders of the company except appellant are in the same position as appellee O. H. Avey, the demands made upon them to have appellee corporation prosecute such an action were disregarded, and the making of any further demand would be a vain and useless thing. It is further alleged that the suit is not a collusive one to confer jurisdiction on a court of the United States, but

is brought in good faith to protect such corporation, enforce its rights and protect its creditors. A decree is prayed, giving appellee corporation a judgment against appellee O. H. Avey for $18,700.00 and awarding appellant the sum of $1000.00 attorneys' fees and costs and for general relief (pages 13-14).

On October 28, 1920, the parties appeared for trial on the issues and appellant began the examination of his witnesses. Whereupon appellees objected to the introduction of any testimony on the ground that the complaint did not set forth facts sufficient to constitute a cause of action against appellees; the objection was sustained, a motion to dismiss followed, was granted, and the decree of dismissal made and entered on November 1, 1920; to all of which proceedings exceptions were duly taken by appellant. This is an appeal therefrom.

The case of H. C. Anderson, appellant, vs. M. F. Albert and Payette Valley Land & Orchard Company, Limited, appellees, Number 3613, was consolidated with this case for trial in the lower court, was disposed of in the same way, raises identical questions upon facts identical except that appellee Albert was not President of the corporation. The parties have stipulated that the decision in this case may be that in the latter and that but one brief and argument—that in the Avey case—need be prepared, filed, served and had. Such stipulation has been approved by this Court.

SPECIFICATION OF ERRORS.

1. The District Court erred in sustaining defendants' objection to the introduction of any testimony on the part of plaintiff.

2. That the District Court erred in making an order dismissing said cause.

3. The District Court erred in entering a decree dismissing said cause.

4. The District Court erred in not permitting the introduction of evidence on the part of the plaintiff.

5. The district Court erred in not hearing said cause upon the merits.

BRIEF OF ARGUMENT.

The errors will be discussed together inasmuch as the determination of the sufficiency of the complaint disposes of all of them.

This is an action brought by the appellant on behalf of the appellee corporation to compel a stockholder of appellee corporation to pay the balance unpaid upon the par value of the stock issued to him. The action is based primarily upon the provisions of the Idaho Statutes relative to such a liability, as well as upon the theory that the financial situation of the appellee corporation and the attempt to relieve that situation by an assessment upon appellant's stock, notwithstanding the fact that the individual appellee, O. H. Avey, has not yet paid the full par value of his stock, makes applicable the theory that the capital stock of a corporation is a trust fund which, appellant urges, not only is it the right, but the duty of the corporation as trustee of that fund, to collect. The ruling of the trial court upon the motion objecting to the introduction of any evidence for the reason that the complaint does not state facts sufficient to constitute a cause of action necessarily was based wholly upon a consideration of the allegations of the complaint which, for the purposes of the motion, must be deemed to be true. A synopsis of the complaint has been set forth in the statement of this brief and the complaint in full with its allowed

amendments will be found in the transcript of record, pages 7-14, and 27-28.

Appellant will first discuss the statutory theory of the right of recovery, and that the court may have the provisions of the statute before it, the following quotations and the pertinent portions thereof are set forth:

Section 9 of Article 11 of the Constitution of Idaho, relating to corporations, provides:

> "No corporation shall issue stocks or bonds except for labor done, services performed, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * *"

And Section 17 of the same Article provides:

> "Dues from private corporations shall be secured by such means as may be prescribed by law, but in no case shall any stockholder be individually liable in any amount over or above the amount of stock owned by him."

Section 4715 of the Idaho Compiled Statutes of 1919 (and this, as were all other sections hereinafter quoted, was in effect at all the times mentioned in the complaint) provides:

> "The directors of corporations must not make dividends except from the surplus profits arising from the business thereof; nor must they divide, withdraw or pay to the stockholders, or any of them, any part of the capital stock; nor must they reduce or increase the capital stock except as in this statute specially provided. For a violation of the provisions of this section the directors under whose administration the same may have occurred, except those who may have

caused their dissent therefrom to be entered in the minutes of the meeting of the board of directors at the time, or those who were not present when the vote was taken, are in their individual and private capacity, jointly and severally liable to the corporation and to the creditors thereof, in the event of dissolution, to the full amount of the capital stock so divided, withdrawn, paid out or reduced * * *."

Section 4728:

"Each stockholder of a corporation is individually and personally liable for its debts and liabilities to the full amount unpaid upon the par or face value of the stock or shares owned by him.

"Any creditor of the corporation may institute actions against any of its stockholders jointly or severally, and in such action the court must determine the amount unpaid upon the stock held or owned by each defendant, and a several judgment must be entered against him for a sum not exceeding such amount.

"Nothing in this title must be construed to render any stockholder individually or personally liable, as such stockholder, for debts or liabilities of the corporation, either at the suit of a creditor or for assessments or calls, to an amount exceeding the balance unpaid upon his stock or the difference between the amount that has been actually paid upon his stock and the par or face value thereof, except when so liable on the ground of fraud or misrepresentation, or concealment, or for neglect or misconduct as an officer, agent, stockholder or member of the corporation.

"No corporation shall issue any stock as paid up, in whole or in part, or credit any amount, assessment or call as paid upon any of its stock, except for money, property, labor or services actually received by the corporation, or actually paid upon the indebtedness of the corporation, as provided in this section, to the full value of the amount credited upon such stock.

"If any stockholder of any insolvent corporation pays the full amount unpaid upon the stock held by him as above defined, upon the overdue debts of the corporation, incurred while he was such stockholder, he is relieved from any further personal liability upon his stock, but not from any liability for fraud, neglect or misconduct. The liability of such stockholder is determined by the amount of stock or shares owned by him at the time the debt or liability was incurred by the corporation, and such liability is not released or discharged by any subsequent transfer of stock.

"When such liability does not arise upon contract, it shall be deemed to be incurred when judgment thereof is obtained against the corporation * * *."

Section 4729:

"All corporations for profit must issue certificates for stock when fully paid up, signed by the president and secretary, or such other officers as may be authorized by the by-laws of the corporation, and all such corporations may provide in their by-laws for issuing certificates prior to the full payment, under such restrictions and for such purposes as their by-laws may provide."

Section 4733:

"The directors of any corporation formed or existing under the laws of this state, after one-fourth of its capital stock has been subscribed, may, for the purpose of paying expenses, conducting business or paying debts, levy and collect assessments upon the subscribed capital stock thereof, in the manner and form, and to the extent, herein provided."

Section 4734:

"No one assessment must exceed 10 per cent of the amount of the capital stock named in the articles of incorporation except in the cases in this section otherwise provided as follows:

"1. If the whole capital of a corporation has not been paid up, and the corporation is unable to meet its liabilities or to satisfy the claims of its creditors, the assessment may be for the full amount unpaid upon the capital stock; or if a less amount is sufficient, then it may be for such a percentage as will raise that amount. * * *"

Section 4751:

"On the day specified for declaring the stock delinquent, or at any time subsequent thereto, and before the sale, the board of directors may elect to waive further proceedings by sale, and may elect to proceed by action to recover the amount of the assessment and the costs and expenses already incurred, or any part or portion thereof."

For the ascertainment of whether or not the complaint states facts sufficient to bring the case within the statutory provisions just quoted, it is necessary

to determine whether or not the complaint shows that there is, in fact, a balance of unpaid par value remaining and, secondly, whether the appellant on behalf of the corporation can require the payment thereof to the corporation.

(A) UNDER THE IDAHO STATUTES APPELLEE AVEY OWED TO THE CORPORATION IN THE NATURE OF AN EXPRESS SUBSCRIPTION THE AMOUNT OF THE PAR VALUE UNPAID UPON THE STOCK ISSUED TO HIM.

That the appellee, O. H. Avey, did not, in fact, pay the par value of the stock for which he subscribed and which was issued to him clearly appears from the complaint. As to 100 of the shares so received, it appears (Complaint, paragraph 8, record pages 10-11) that Avey transferred to the corporation for such shares what was claimed to be a one-seventh equity in certain land, but it further appears that in fact he had no such equity in such land or any part thereof except a mere option to purchase the same, which option was without any value to the corporation at all, and particularly not of the value of the shares issued; and not only did Avey have knowledge of this as an individual but also as the President and a director of the corporation. If in truth such purported equity had no value as is alleged in the complaint, then it is clear that Avey has paid nothing on said one hundred shares of stock and if he is liable for anything by reason thereof, he is liable for the entire par value of said shares. It further appears from the complaint as to 116 shares purchased by Avey (Complaint, paragraph 8; Record, pages 11-12) that only twenty-five dollars was paid per share although the par value was $100.00, and as to these shares it is clear that if Avey is respon-

sible for any payment thereon, in addition to what he has already paid, he is responsible for $75.00 per share as alleged in the complaint.

But it further appears in portions of the complaint above cited that in each case the stock was issued as fully paid, and it, therefore, becomes necessary to ascertain whether or not issuing said stock as fully paid makes it such, so far as the liability of Avey is concerned, notwithstanding the fact that nothing, or only a portion of the par value, was actually paid. We are not here concerned with what might be the rule in the absence of any statute because the statutes of the State of Idaho contain particular provisions relating to this very matter, and it is the construction of such statutes that will govern.

It will be observed that the complaint alleges that appellee O. H. Avey is now and at all times since the organization of the corporation has been a member of the board of directors and the president of the appellee corporation, and that in his transactions with the corporation he was not only acting on the one side of the transaction as an individual, but was acting on the other side of the transaction as one of the directors of and the President of the corporation with which he dealt in acquiring his stock, and it is also notable that the other directors of the corporation were engaged in exactly similar transactions (Complaint, paragraphs 6, 7, 8; Record, pages 9-12). This not only required of Avey the utmost good faith in this transaction, but gave to him a knowledge, not only presumed, but actual, of the conditions under which the corporation could contract for the sale of its stock. In other words, he not only had presumed, but had actual knowledge of the provisions of the statute hereinbefore quoted, and such

provisions became an essential and non-waivable condition of his purchase and acceptance thereof. Specifically, then, he knew that any term of a contract which he might make for the purchase of stock without payment of par value would be invalid and would have the practical effect of dividing, withdrawing and paying to a stockholder (himself) part of the capital stock and of reducing the capital stock other than as specifically provided in the statute (Section 4715, Compiled Statutes, 1919, supra). He further knew, and to this we draw the court's particular attention because it is the very meat of this proposition, that

> "*No corporation shall issue any stock as fully paid up* in whole or in part or credit any amount, assessment or call paid upon any of its stock, *except for money, property*, labor or services *actually received by the corporation*, or actually paid upon the indebtedness of the said corporation as provided in this section, *to the full value of the amount credited upon such stock.*"
>
> Section 4728, Idaho Compiled Statutes, 1919; Sections 9 and 17, Article 11, Constitution of Idaho, supra.

The taking of stock by Avey constituted a subscription therefor.

> Volume 1, Thompson on Corporations, 2d Ed., Section 557, page 668; Section 573, page 689; Section 583.

And it became a binding subscription for the full par value of the stock relieved from the status of paid up stock since such status was contrary to the power of the corporation and the statutory provi-

sions, as Avey, both as an individual and as director and officer of the corporation, well knew.

Putnam v. New Albany & Sandusky etc. Co., 83 U. S. 390, 21 L. ed. 361.

14 Corpus Juris, "Corporations," Sec. 849, p. 569.

Quartz Glass etc. Co. v. Joyce, 150 Pac. 648 (Cal.).

"It is clear that a corporation has no power to accept a subscription upon stipulations or conditions that are contrary to its charter or that are prohibited by statute; that is, a corporation is not authorized to agree to perform any condition or stipulation which is prohibited by the charter or by statutory law, or which is contrary to public policy, or a fraud upon either the corporation itself or the other subscribers. Where such stipulations are made and the subscriptions received, the general rule is that the subscription is binding on the subscriber, and that the stipulations can neither be set up as a defense to an action upon the subscription, nor can they be made the foundation of an action against the corporation. Mr. Halliwell has stated the rule as follows: 'It must be distinctly observed, however, that a corporation not only may not bind itself to violate law or act in contravention of public policy, but that the distinct limitations upon its powers as an artificial being which it may not exceed directly it may not bind itself to exceed. The powers of a corporation defined by law or by its articles of incorporation are matters of public notice. Where, therefore, a party has attached to his subscription a condition subsequent, the performance of

which would involve the corporation in a course of procedure in violation of law or public policy, or in excess of its charter powers, the condition may be disregarded, and the subscription deemed absolute.' This principle is applied in cases where the charter of the corporation or the general laws require the payment of the capital stock in full, and subscription is to be paid, or that the money when paid, is to be returned immediately to the subscriber."

1 Thompson on Corporations, 2d Ed., Sec. 629, page 761.

In Jensen vs. Aikman, 32 Idaho 261, 181 Pac. 525, a creditor brought an action against a stockholder to recover the unpaid par value of stock owned. The Idaho Supreme Court, in considering the complaint in that case, stated:

"While an agreement that the stock was not to be paid for, if such agreement was made, may be void, the subscription is valid, and the stockholder's liability is binding."

Meholin vs. Carlson, 17 Idaho, 742; 107 Pac. 755.

Feehan vs. Kendrick, 32 Idaho 220; 179 Pac. 507.

With this view of the case it needs no argument to reach the one conclusion that the corporation is entitled to recover on this subscription.

(B) AVEY'S ACCEPTANCE OF STOCK RAISED AN IMPLIED PROMISE TO PAY THE PAR VALUE THEREOF.

And the same result is reached by ignoring the express subscription and its enforcement and con-

sidering only the terms of the statute. It is appellant's contention that the whole course of legislation hereinbefore quoted indicates unequivocably the legislative intent that the par value of shares of stock shall be paid either in money or money's worth and while the certificates of stock may be issued prior to full payment yet full payment must be secured in some way and certainly cannot be waived. This provision is as much for the benefit of other share holders as it is for creditors or the corporation itself and when the matter is viewed from that standpoint it must follow that the acceptance of the shares raises an implied or quasi contract to pay for them to the statutory extent. That implied contract is for the benefit of the corporation, its creditors and share holders, and the corporation must be entitled to enforce that obligation. In fact, the statute specifically recognizes that power and right by providing that the directors after one-fourth of the capital stock has been subscribed may "for the purpose of *paying expenses, conducting business, or paying debts, levy* and collect assessments upon the subscribed capital stock thereof in the manner and form and to the extent herein provided." (Section 4733, Idaho Compiled Statutes, 1919.)

The Idaho Supreme Court in Wall vs. Basin Mining Company, 17 Idaho 317; 100 Pac. 753; 22 L. R. A. (N. S.) 1013, held that the word "assessment" as used in this section referred as well to "calls" for unpaid subscription.

Such a liability on the part of the stockholder is an asset of the corporation which it may collect, not only for the purpose of paying debts but as said in the statute just above quoted, for the purpose of conducting its business.

Pettus vs. Lynde, 106 U. S. 519; 27 L. Ed. 265.

Powell vs. Oregonian R. R. Co., 3 L. R. A. 201.

Du Pont vs. Ball, 106 Atl. 39 (Del.)

Rosoff vs. Gilbert Transportation Co., 221 Fed. 972-986.

Mathers vs. Western Carolina Bank, 47 S. E. 893 (N. Carolina).

In connection with the statute above quoted giving the right to the corporation to collect the unpaid par value of the stock it should not be overlooked that Section 4715, Idaho Compiled Statutes, 1919, hereinbefore quoted, prohibits the dividing, withdrawing or paying to the stockholders or any of them any part of the capital stock or reducing the capital stock except as specifically provided by the statute. If this is done the directors under whose administration the same has occurred are individually and severally liable *to the corporation.* Certainly the issuance of stock to the directors themselves at a value much less than par and in the face of the statutory prohibition is in effect, and results in exactly the same way as, a withdrawal, division, or payment of capital stock to such persons, and while it does not on its face reduce the capital stock it does in fact do that very thing. The appellant urges that reading the various sections of the statute together makes it clear that it was the legislative intent for the corporation itself to collect the unpaid par value and particularly it was the intention that it should have such power whenever the contingency of paying the expenses, conducting its business or paying its debts arose; such a

contingency is set out in the complaint because it is alleged that for several years the corporation has been practically insolvent (Record, pp. 27, 28). That is to say, its indebtedness has exceeded its assets by some $60,000.00 and it is necessary in order to pay such creditors and continue operations as a going concern that the unpaid par value be collected. And this, Avey as one of the directors recognized in that for the purpose of raising funds to pay debts he with others of the directors and holders of the majority of the stock of the corporation attempted to levy an assessment on appellant's stock and will attempt to assess such stock further on account of the condition of the company. (Record, page 13.)

It should not be overlooked in determining the legislative intent to permit the corporation itself to collect the unpaid par value that the third subdivision of Section 4728, Idaho Compiled Statutes, 1919, provides:

> "Nothing in this title must be construed to render any stockholder individually or personally liable as such stockholders for debts or liabilities of the corporation *either in the suit of a creditor or for assessments or calls to an amount exceeding the balance unpaid upon his stock or the difference between the amount that has been actually paid upon his stock and the par or face value thereof.*"

And also that subdivision 1 of Section 4734 provides that:

> "If the whole capital of the corporation has not been paid up and the corporation is unable to meet its liabilities or satisfy the claims of its creditors the assessment may be for the full amount unpaid upon the capital stock. * * *"

In Whitewater Tile and Pressed Brick Manufacturing Company vs. Baker, 125 N. W. 984, it appeared that the treasurer of the company had received a bonus of six shares for which he had paid nothing. The Wisconsin statute required that the full par value of stock be paid and the corporation sued for the par value of the six shares; it was held that the corporation might treat the stock as valid and recover its par value.

The same transaction, except that it involved a different defendant, was before the court in Whitewater Tile & Pressed Brick Manufacturing Co. v. Johnson. The opinion of the Wisconsin Supreme Court is reported at 175 N. W. 786, in which the court says:

> "The issue of stock at less than its par value or with an understanding that part of it is not to be paid for is contrary to the provisions of Section 1753, statutes 1898, and when such fact appears then the issue is fraudulent in law irrespective of the intent." (After finding that there was no conspiracy between the stockholders, the court continued):
>
> "That being so, only an individual and not a joint liability resulted.
>
> Under the facts found and under the rule laid down in Whitewater Tile & Pressed Brick Co. v. Baker, 142 Wis. 420, 125 N. W. 984 (supra) the court should have entered judgment against the defendant for the difference between the par value of the stock issued to him and what he paid therefor."

(C) THE CAPITAL OF A CORPORATION IS A TRUST FUND FOR CREDITORS AND STOCKHOLDERS AND IF SOME STOCKHOLDERS HAVE NOT PAID PAR VALUE FOR THE STOCK, THE CORPORATION AS TRUSTEE MAY COLLECT THE UNPAID PART, PARTICULARLY WHEN THE CORPORATION REQUIRES SUCH FUND TO CONTINUE BUSINESS, PAY CREDITORS AND PREVENT AN ASSESSMENT AGAINST THE STOCK OF AN INNOCENT STOCKHOLDER.

We turn now to the other proposition on which this action may be sustained; That is the theory which has been denominated the trust fund theory. It needs neither argument nor citation of authorities for the general proposition that the capital stock of a corporation is a trust fund for the creditors of that corporation. Such a proposition is recognized by the statutes of the State of Idaho hereinbefore quoted and is a well known American doctrine even in the absence of similar statutes.

Feehan vs. Kendrick, 32 Idaho 221; 179 Pac. 507.

Barnard v. Carr, 83 S. E. 817, and cases therein cited.

Eastern National Bank vs. American Brick & Tile Co., 6 Atl. 54, 57.

14 C. J. "Corporations," pages 950 to 962, incl.

Nor are we concerned with any steps which the creditor himself might take to enforce this liability in his favor. It is appellant's contention, however, that it is not only the right but the duty of this corporation to take all steps necessary to collect its assets, in this case the unpaid par value of the stock

issued as alleged in the complaint—not only because the statutes of the State of Idaho make it such duty and give it such right but because of the peculiar equitable situation which presents itself in favor of the appellant, a stockholder in the appellee corporation.

There has already been discussed the proposition as to the necessity for payment in full of the stock issued by an Idaho corporation and the proposition that in this case the appellee Avey does under the statutes and in fact owe a balance on his stock.

Appellant contends that the corporation as the trustee of this fund can under the contingencies which are shown to exist in this case—namely the practical insolvency of the company—collect this fund, and that he as a stockholder who is about to be assessed for the payment of these debts can require that it so collect because under the circumstances that fund is not only a trust for the creditors but a trust for him and if the corporation does not enforce it it will result in his injury.

As has been said, the corporation in this case is heavily indebted and has been for a considerable time, owing some $60,000.00 above its assets. This in itself creates a duty upon the part of the corporation to collect the unpaid par value of its capital stock.

> "The creditors have the right to have such funds collected and applied to the discharge of their debt. If the capital stock has not been paid for by those to whom the certificate has been issued *it is the plain duty of the directors or of the court to require it to be collected*, or so much thereof as may be necessary to discharge the unpaid debts."
>
> Barnard v. Carr, 83 S. E. 816.

> "In common law a stockholder was to the extent of the amount unpaid on his stock liable for the corporate indebtedness, (7 R. C. L. 356) *either through the corporation* represented by an assignee or a receiver or by the creditors individually."
>
> Feehan vs. Kendrick, 32 Idaho 220-223.

The statutes of Idaho heretofore quoted specifically recognize the duty and the power of the corporation under such contingencies to collect such unpaid par value. This is specially provided by Section 4733:

> "The directors of any corporation formed or existing under the laws of this state after one-fourth of its capital stock has been subscribed may *for the purpose of paying expenses, conducting business or paying debts* levy and collect assessments upon the subscribed capital stock thereof in the manner and form and to the extent herein provided."

And as hereinbefore pointed out the Supreme Court of Idaho has held that this is applicable to collection of calls upon the unpaid portion of the par value of stock issued. The foregoing section is followed by Section 4734, which provides:

> "No one assessment must exceed ten per cent of the amount of the capital stock named in the articles of incorporation *except in the cases in this section otherwise provided as follows*:
>
> 1. If the whole capital of a corporation has not been paid up and the corporation is unable to meet its liabilities or to satisfy the claims of its creditors the assessment may be for the full amount unpaid upon the capital stock. * * *"

And it is provided by Section 4751 that the board of directors may elect to proceed by action to recover the amount of the assessment.

Wall vs. Basin Mining Co., 16 Idaho 313, 101 Pac. 733; 22 L. R. A. (N. S.) 1013.

But the appellant further contends that the instant case presents a situation which makes it a duty of the corporation to bring its action and collect the unpaid amount because otherwise an intolerable burden would be placed upon him. It appears as has hereinbefore been pointed out, that an assessment upon appellant's stock was levied by this very board of directors which issued to itself stock at less than par though denominated fully paid stock. This same board of directors, in order to pay an indebtedness which the creditors of the corporation could directly enforce against them, have attempted and will probably attempt in the future to raise the money necessary to pay off the creditors and to continue the business of the corporation, not out of the capital stock which the statutes intended should constitute the funds for that purpose, but as an additional contribution from this appellant. Equity certainly will never permit such a situation to continue nor such an unjust contribution be forced from appellant. The situation disclosed by the complaint requires the most rigid application of the principle that the board of directors must act in good faith and requires that no matter what the rules may be in general as to the power of the creditors themselves or of corporations on their behalf to recover unpaid portions of the par value of the stock issued, the situation in this case requires that equity permit this stockholder on behalf of this corporation to enforce such liability against the stockholder who would otherwise gain

such an unjust and unconscionable advantage; that in the situation here disclosed the corporation must be required to act as a trustee for the stockholder and collect the trust fund—its capital.

(D) THE LEGISLATURE OF IDAHO INTENDED TO REQUIRE FULL PAYMENT FOR ALL CORPORATE STOCK FOR THE PROTECTION OF INVESTORS.

And there is another reason why this decision of the trial court should be reversed in this case. A corporation of the State of Idaho exists by virtue of the authority conferred upon it by the Constitution and Statutes of the State. The powers and authority of a corporation created under the law of the State of Idaho are therefore determined by the provisions of the Constitution and the enactments of the State Legislature in force and effect at the time of the creation of said corporation. At the time the Payette Valley Land & Orchard Company, Ltd., was created there was in force and effect in the State of Idaho a provision of the statute which said, "No corporation shall issue any stock as paid up in whole or in part, etc." (Sec. 4728 supra.) The purpose of this enactment was unquestionably to insure to every person who came into any business relation with the corporation that the amount of its capital stock was equivalent to the amount of its actual capital fund as shown by its books. Had the legislature merely intended to create a creditor's liability it would not have enacted the fourth paragraph of Section 4728, Idaho Compiled Statutes. Stockholder's liability was established by the first paragraph of said section, and the fourth paragraph of said section relating to the issuance of stock as paid up was to insure that whenever the corporation issued

stock as paid up in full and thus asserted receipt of full value for it, it have its equivalent in money or money value.

The complainant in this case alleges that he is the owner of a large part of the issued and outstanding stock of the corporation and that the issuance of stock to the appellee, Avey, under the circumstances as stated in the complaint was without his knowledge and consent.

We contend that one of the purposes of the enactment of the fourth paragraph of Section 4728 was to protect not only creditors but the persons who invested money in the corporation as stockholders. We urge that it was the intention of the Legislature in enacting the statute above referred to to enable the stockholder who has invested his money in the capital stock of a corporation to institute and maintain a suit to collect the unpaid balance due on stock which has been issued as fully paid up and it was the intention of the Legislature to give this right in order to protect those who might become purchasers of the stock of a corporation and who, under the statute, have the right to rely upon the showing of the books of the corporation as to the amount of its invested capital. As we view this matter, unless this was the intention of the Legislature, the provision of the statute referred to is meaningless and without effect. In this connection it must be borne in mind that a business corporation is organized for the purpose not only of carrying on business itself but to enable a large number of investors to pool their capital. Large numbers of corporations are organized for the purpose of inducing individuals to contribute such capital as they may have to the common enterprise and the Legislature having knowledge of

this fact enacted the provision of the statute relating to the issuance of stock which is not paid up in full. It was with the intention of placing all the investors in an equal position that this provision was enacted and it follows therefore that when a person has invested in the capital stock of a corporation without knowledge of the fact that other persons have secured stock as fully paid up when in fact it was not fully paid up such an individual may, in the event the corporation refuses to do so, maintain an action for recovery of that amount to the corporation.

For the foregoing reasons the appellant contends that the trial court erred in refusing to permit the introduction of evidence and in dismissing the cause; that the complaint as filed does state facts sufficient to constitute a cause of action against the appellees and the cause should be remanded to the trial court with instructions to proceed with the hearing and to determine the cause upon its merits.

Respectfully submitted,

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